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International Economic & Energy Weekly

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6 July 1984

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International Economic & Energy Weekly 25X1

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Secret
6 July 1984

 25X1

International Economic & Energy Weekly 25X1

Synopsis

1 **Perspective—*Argentina: Pressures For and Against Reaching an IMF Accord*** 25X1

There are several indications that the Argentine Government recognizes the importance of achieving an IMF accord, but negotiations will be rocky, and certain factors could threaten an agreement. 25X1

13 **Egypt: Oil and the Balance of Payments** 25X1

Oil revenues are expected to decline substantially by the end of the decade, requiring Egypt to find alternative revenue to fund its large current account deficits or institute austerity measures that would risk domestic instability. 25X1

19 **Population and Labor Force Consequences of the Iran-Iraq War** 25X1

The Iran-Iraq war should not place demographic constraints on postwar recovery as did the heavy manpower losses in Europe after World War I. 25X1

23 **World Rice Market: Buffeting the LDCs** 25X1

Global rice reserves that were accumulated to record levels in the late 1970s have fallen to the lowest level in eight years. At the same time, LDC rice importers, lacking foreign exchange, have been forced to curtail purchases of foreign rice, keeping world prices low. 25X1

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International Economic & Energy Weekly [redacted] 25X1

6 July 1984

Perspective

Argentina: Pressures For and Against Reaching an IMF Accord [redacted] 25X1

The agreement reached between the Argentine Government and foreign bankers to clear arrearages through 2 April once again demonstrates pressures on the parties to avoid confrontation and negotiate what they probably perceive as a less costly solution to the debt problem. The bankers contributed $125 million toward payment of the remaining $350 million in overdue interest without an IMF agreement in place. For its part, Argentina drew down $225 million in reserves and pledged to continue Fund negotiations. [redacted] 25X1

We expect Buenos Aires to maintain its tough negotiating posture with bankers and the Fund. Nonetheless, the government will be under considerable financial pressure to reach an IMF agreement this quarter. It must pay $900 million in interest payments over the next three months in addition to $400 million to repay short-term loans made by Latin American governments and US banks as part of a 30 March agreement on overdue interest payments. An IMF-supported adjustment program would pave the way for negotiations with bankers on rescheduling $10-12 billion of its $43 billion debt and arranging $3-4 billion in new credits. [redacted] 25X1

We see several indications that the government recognizes the importance of achieving an IMF accord. For example, [redacted] the government is willing to accept a further reduction in the budget deficit and a sharper devaluation. Wage policy remains a contentious issue because the government promised to increase real wages by 6 to 8 percent this year. Even on this issue, however, press reports indicate that the government is discussing various alternatives, including smaller increases to high wage earners and holding some increases in escrow. [redacted] 25X1

At the same time, negotiations will be rocky, and we are wary about Buenos Aires's ability to clear roadblocks quickly. The government's hardline public statements regarding a Fund-supported adjustment program constrain the government's bargaining position and could stall the talks. Moreover, as first coordinating secretary for the Latin debtors' consultative group formed at Cartagena, Argentina will want to be able to demonstrate that it has shifted the emphasis of adjustment programs to more growth-oriented policies. We expect Buenos Aires will continue to exhibit a schizophrenic negotiating posture as it attempts to win concessions through radical demands while remaining cautious about disrupting the current debt negotiating process. [redacted] 25X1

Although Alfonsin seems to be moving toward an agreement, certain factors could threaten an accord. Further rises in interest rates will complicate discussions, and if, as some market analysts predict, the US prime rate were to rise by two percentage points in the coming months, we believe negotiations could be abandoned. Both domestic and regional political pressures would build for Argentina to achieve an unconventional debt agreement with the banks and to involve the industrial countries in a more comprehensive solution to the debt problem. In addition, it is not clear that Alfonsin will be able to get labor to go along with some of the wage compromises being considered. Alfonsin has thus far been unsuccessful in winning the cooperation of labor and has yet to demonstrate the will to face down labor in the event of a direct confrontation over a Fund provision. Although the Argentine legislature does not have the authority to amend or veto a Fund agreement, Peronist congressmen could frustrate compliance with its provisions through the budgetary process. [redacted] 25X1

In a worst case, Alfonsin might decide that the political risks to his government would be greater if he adopted an IMF-supported program than if negotiations with the Fund and subsequently with the banks collapsed. In reaching his decision, he could point to some $1.3-1.5 billion in reserves, a trade surplus that could reach $4 billion this year, and near self-sufficiency in oil and food. Moreover, by August he should have some notion about the size of next year's wheat crop and be able to make some projections regarding future export earnings. [redacted] 25X1

[redacted] 25X1

Briefs

Energy

Spot Oil Market Trends

Indications that oil stocks in the second quarter increased more rapidly than most industry analysts had anticipated has forced spot crude oil prices steadily downward in recent weeks. Arab Light crude is selling at $27.65 per barrel—$1.35 below its official price—while Brent and Bonny Light crudes are quoted at $28.25 and $28.75 per barrel, $1.75 and $1.25 below their official prices, respectively. 25X1 Spot crude oil and product prices are now at their lowest level so far this year. We expect this price weakness to discourage OPEC from increasing production quotas at the upcoming meeting. Indeed, some analysts believe that 25X1 OPEC members will be forced to restrain production to the current ceiling of 17.5 million b/d in the third quarter to prevent further price deterioration.

USSR's Export Pipeline Construction Problems

Western engineers have told the US Embassy in Moscow that compressor station construction on the Soviet gas export pipeline is plagued with poor management and damage to expensive imported equipment, including extensive pilferage of parts. As a result, the project may not be completed until the end of 1986. The Minister of Gas Industry has dismissed at least two regional project managers, and Council of Ministers Deputy Chairman Dymshits apparently is now overseeing the project. 25X1

The delays and mishandling of equipment are typical of Soviet construction 25X1 projects. The engineers' observations support earlier estimates that, even without the US embargo, completion of compressor stations would take until late 1986. The delays annoy Western contractors and embarrass the Soviets, but they will not prevent deliveries of required quantities of gas. The Soviets can make limited use of the export pipeline and, if necessary, use one of the other pipelines from Urengoy. 25X1

Iranian Oil Export Contingency Planning

The Dutch have offered Tehran use of storage facilities in Rotterdam, and Iran also has decided to buy five oil tankers to shuttle crude from Khark to locations outside the Persian Gulf. 25X1 These latest 25X1 contingency plans underscore Tehran's concern about the impact of further Iraqi attacks on Iranian oil exports. Even at current export levels, Iran could lose up to $1 billion this year because of price discounts. 25X1

Turks To Buy Soviet Gas

[redacted]

A joint Turkish-Soviet economic commission has agreed on a pipeline to bring Soviet natural gas to Turkey. The pipeline will have an initial capacity of 2 billion cubic meters, rising later to 5 bcm. [redacted] talks about the purchase of natural gas will get under way in Moscow in late July or early August, and the project is expected to be completed in 1987. [redacted] 25X1 25X1

Aside from providing Moscow with potential earnings of around $650 million annually, Soviet gas sales to Turkey could effectively block access to the European gas market by potential suppliers in the Middle East, where 45 percent of world non-Communist gas reserves are located. Markets in Turkey and Greece are key steppingstones for suppliers in the Middle East to enter the larger West European market; Middle Eastern suppliers will need to sell gas in transit to minimize the cost of delivery. By attempting to expand sales of its own to potential customers in Turkey or Greece, Moscow no doubt hopes to minimize future competition from Middle Eastern suppliers. Iran eventually abandoned consideration of a gas export project to Turkey and Western Europe following the signing of the joint protocol between Turkey and the USSR on a gas pipeline feasibility study in 1983. [redacted] 25X1

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[redacted] 25X1

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Australia Opens Major Oil Pipeline

A 500-mile pipeline linking Jackson oilfields in southwestern Queensland with refineries in Moonie and Brisbane recently went into operation. The 55,000-b/d pipeline is currently carrying a flow of about 10,000 b/d, which should increase to 25,000 b/d by 1985. The presence of the pipeline has spurred extensive oil and gas exploration in this remote area, with current activity almost equaling all cumulative exploration prior to 1984. Several new oil and gas discoveries have been made, and studies are under way to determine how best to exploit gas finds. Although future exploration may be slowed by the newly imposed federal tax on recently developed oilfields—a move strongly opposed by many oil companies—drilling activity in 1984 is likely to reach record levels. [redacted] 25X1

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International Finance

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Guyana's Search for Help

Guyana's President Burnham last week announced the results of his June visits to Bulgaria and the PRC, claiming that Sofia will extend more than $100 million in development aid. The PRC, however, has made it clear it will not provide any new economic aid. Georgetown is ineligible for IMF loans until it pays off its arrears to the Fund. This has stymied efforts to obtain aid from traditional Western donors. Even if Bulgarian project aid materializes, it will not ease Guyana's immediate foreign exchange shortage. According to the US Embassy, cash holdings of the Cenral Bank were only $180,000 in mid-June, and there is little prospect for improvement until sugar exports begin in late July. 25X1

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Global and Regional Developments

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Soviet Grain Purchases

[redacted]

The USSR bought at least 300,000 but perhaps as much as 1 million metric tons of US wheat on 27 and 28 June for late summer shipment. The Soviet traders are described as having "a definite appetite" for US wheat, and [redacted] may buy 2-3 million tons in this round of purchases for shipment by September. If the Soviets did indeed buy 1 million tons, it would bring purchases for the October 1983–September 1984 year under the US-Soviet long-term agreement to 11.8 million tons. This would be above the 9-million-ton minimum under the agreement but well below the 22 million tons the Soviets are allowed to buy this year without prior consultation. Earlier this month Soviet export officials claimed to be basing import needs on a Soviet grain harvest of about 180 million tons. Although production could fall to this level, continuation of the recent favorable weather would permit a crop as high as 200 million tons. The recent Soviet purchasing may reflect Soviet anxieties about their domestic crop, availability of grain on the market, and the effect of wet US weather on future grain prices. [redacted] 25X1

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Economic Talks Between USSR and Iran End

[redacted]

The Soviet Deputy Minister for Power and Electrification—the first Soviet official to visit Iran since April 1983—left Tehran last week after several days of talks. Iranian media noted that the two sides signed a memorandum calling for the completion of power stations at Ahvaz and Esfahan under contracts with the Soviets and the construction of a dam on the Aras River, which forms part of the Soviet-Iranian border. Soviet media, on the other hand, noted that such an agreement was submitted by the Soviets for study. The Iranians portrayed the visit in a positive light, but Soviet media barely mentioned it. [redacted] 25X1

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The content of the talks was less important than the fact that the visit took place. The two sides evidently are attempting to resolve at least some of their differences on the Ahvaz power plant. [redacted] It is not clear whether the agreement on the Aras River dam is a new accord or an elaboration on existing agreements. [redacted] 25X1

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National Developments

Developed Countries

[redacted]

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[redacted]

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Major French Business Failure

[redacted]

Creusot-Loire, France's largest heavy engineering firm, has been placed in receivership following a failure by the government and shareholders to negotiate a rescue package. The government refused to aid the company unless shareholders provided additional funds. The government wanted to save Creusot, a leader in technology and exports, but refused to reverse the "self-reliance" doctrine it has been preaching for the last year. The firm has been in financial trouble for several years, in part because of its steel operations. Its subsidiaries and branches in nuclear engineering, high-speed trains, subway equipment, and military equipment should be able to continue operation. Creusot employs 30,000 workers directly and perhaps 100,000 indirectly through subcontractors. [redacted]

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Rice Shortage May Harm Tokyo's Fiscal Plans

[redacted]

The possibility of a small rice shortage caused by bad weather and the contamination of 200,000 metric tons of rice may enable farmers to scuttle a government plan to reduce rice acreage. Farmers—already opposed to the government plan—were incensed when Tokyo recently arranged to import South Korean rice but failed to modify its rice acreage reductions. The government would like to reduce the huge subsidies it pays to farmers. Japan in the past has had an oversupply of rice, but stocks have been sharply reduced. Although any shortfall probably would represent no more than 1 percent of total rice consumption, rice and food security are emotionally charged issues, and the current situation has received front-page coverage for almost a month. [redacted]

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Canada Raises Ceiling on Foreign Bank Assets

[redacted]

Parliament enacted legislation last week doubling the share of the Canadian banking industry that can be held by foreign banking subsidiaries. Foreign banks were first allowed to operate in Canada in 1981, but their combined assets have been limited to 8 percent of the country's total banking assets. They quickly reached the 8-percent ceiling in part because the domestic industry has grown very slowly. Under the new bill, the ceiling will be raised to 16 percent, and Ottawa hopes that, in return, the foreign banks will lend more money to small businesses. Foreign banks have concentrated their efforts thus far on the corporate lending sector—mostly dealing with medium-sized companies. [redacted]

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Most domestic banks support the new legislation although a few of the smaller banks which specialize in lending to medium-sized companies fear they may be hurt. The five largest banks are not worried about increased domestic competition because of their international activities. They had hoped, however,

that the bill would require reciprocal treatment for Canadian banks operating in other countries—many of which have restrictions greater than those of Canada. The foreign banks had hoped for an elimination of limits on their assets, but Ottawa considers domestic control of the banking industry vital to the national interest and was unwilling to lift restrictions entirely. [redacted] 25X1

South African Financing of Corn Imports

Pretoria has decided to use foreign exchange reserves and gold-swap arrangements to finance approximately $800 million of corn imports over the next year, [redacted] 25X1 25X1 25X1 Three successive years of drought have reduced corn production from an average of 10 million tons a year to 2.7 million tons this year; annual consumption has averaged 7.2 million tons. According to the US Embassy and other reporting, Pretoria plans to continue making the bulk of its grain purchases from the United States. [redacted] 25X1

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Australia Unveils New Auto Policy

Australia's Minister for Industry and Commerce has proposed a program to streamline the country's automobile industry and reduce costs. Major features of the proposal include:

- Easing tariffs and quotas on automobile imports.
- Consolidating the number of producers from five to three and car models from 13 to six. 25X1
- Lowering local content requirements from 85 percent to 70 percent by 1987.

Australia's five domestic manufacturers—Ford, General Motors–Holden, Toyota, Nissan, and Mitsubishi—together produce about 400,000 vehicles per year. Short production runs, coupled with high fixed manufacturing costs, result in high prices. [redacted] 25X1 We believe the new policy, if adopted, will not appreciably lower costs for several years. [redacted] 25X1

Less Developed Countries

Lebanese Economic Losses Tallied

Lebanon's economy has suffered at least $1 billion in lost trade and domestic commerce since the Israeli invasion in 1982, according to the US Embassy in Beirut. The influx of low-cost Israeli goods, in particular, has undercut agricultural production in southern Lebanon. Export receipts—down by 49 percent last year—have failed to rebound because Saudi Arabia and Iraq maintain trade restrictions to prevent importing Israeli-origin goods. Almost half of the labor force has been totally or partially idled. The US Embassy reports that unemployed workers until now have relied on savings and family ties to tide them over, but these resources are being rapidly exhausted. Popular disillusionment with the government's inability to restore order is growing. This probably will prompt increased enlistments for pay in the various factional militias and further emigration. [redacted] 25X1

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Record Indian Harvest Dampens Import Demand

We estimate India's 1983/84 (July/June) foodgrain production at 150 million metric tons, 16 percent more than the previous, drought-troubled season. The bumper crop resulted from above-average rainfall, increased government procurement prices, and higher fertilizer subsidies. Increased domestic procurement by the government as well as imports of 3.3 million tons have pushed stocks to a near-record 21 million tons. A key factor determining India's future foodgrain imports will be government stocks, which supply the country's vast public distribution system. Large wheat stocks probably will eliminate wheat imports in the 1984/85 crop year, but low government rice stocks and buoyant domestic prices may force New Delhi to purchase rice. 25X1

Pakistan's Election Budget

The budget for the fiscal year that started on 1 July is the most conservative of the martial law period. To avoid a large deficit, the Pakistanis are projecting expenditures to grow by only 11 percent, compared with more than 20 percent in the previous two years. Revenues are projected to grow by almost 13 percent, with government-proposed price increases for energy products, cigarettes, and beverages. The Zia government anticipates calling elections later this year, and the budget is intended to be as noncontroversial as possible. Islamabad has again avoided introducing any serious tax reform that would be politically unpopular. Moreover, we believe that the government will not fully implement the proposed price increases—the US Consulate in Karachi reports there already is grumbling in the city over possible price hikes. Instead, development expenditures probably will be cut below the budgeted level as has occurred the past two years. The government's spending and tax policies have worked to moderate inflation and to avoid alienating consumers but have come at the expense of education, health care, and economic development projects. 25X1

Sudan Stops New Interest Accounts

Sudan's central bank governor unexpectedly has decreed Islamic principles to the banking system despite earlier promises that Islamization would be partial and gradual. According to US Embassy reporting, non-Islamic banks in Sudan have been ordered to convert to Islamic principles for all new business. One section in the new Civil Procedures Act specifies that "any condition included in a contract entailing additional benefit over the amount loaned will be null and void," according to Embassy reporting. Instructions on how the process is to work, however, have not been issued, and bankers have been advised that Sudanese Islamization will not be based on the Pakistani and Saudi models. In these countries, interest payments have been replaced by profit-sharing and management fees. 25X1

The revamping of the banking system is another example of President Nimeiri's determination to forge ahead with his brand of Islamization, apparently without consideration of the consequences. Uncertainty about the direction of the domestic banking system and fear of Islamic punishment has prompted bankers to reduce significantly domestic banking activity, although it is unlikely that the new rules will interfere with Sudan's international

financial relations. While most foreign bankers operating in Sudan—including a US branch—will probably take a wait-and-see attitude until further clarification is made, these latest actions will curb transactions and could lead some foreign banks to reconsider their operations. 25X1

Communist

Soviets Renew Technical Agreement With United States

The Soviets decided this week to renew unconditionally the 10-year bilateral agreement on economic, industrial, and technical cooperation. In a diplomatic note delivered barely 24 hours before the accord was due to expire, the USSR agreed to an extension through 28 June 1994 without reference to its previous demands. These demands were for Aeroflot's recertification in the United States, easing restrictions on Soviet merchant ships, and immediate resumption of the Joint Commercial Commission. Moscow's decision to renew at the last minute probably indicates that it does not want to jeopardize any further the access the Soviets have to US technology, especially the acquisition of offshore oil-drilling equipment and know-how. 25X1 25X1

USSR Provides New Project Credit to Yugoslavia

Yugoslavia's official press reports that the USSR has granted Yugoslavia a $180 million credit to finish expanding the financially troubled Smederevo steel mill complex in Serbia. Serbia has been trying to complete the expansion for years but has been unable to secure international financing. The credit may be intended as a reminder of the USSR's importance to Yugoslavia. It may also be a goodwill gesture toward the dominant, historically eastward-leaning Serbs and thus be resented by other republics, which are being forced to close some of their enterprises. Smederevo's sales currently cover only plant-operating costs, and the Serbian economy is burdened with repayment of an estimated $2.8 billion in hard currency debt for past capital investment in the project. 25X1 25X1

Romanian Meat Shortages

Romanian officials are concerned that shortfalls in meat production this spring could spur worker discontent and diminish hard currency earnings. 25X1

25X1 A below-average grain harvest last year and continued low levels of feed imports probably account for most of the decline in meat production. Little near-term relief is likely—a prolonged drought last fall and excessively wet weather this spring presage a mediocre harvest at best. A consequent reduction in livestock numbers ultimately would hurt sales of meat to the West for hard currency and barter with the USSR for oil. In addition, a severe shortage in meat supplies—a major factor in the worker unrest of 1980-81—would further depress worker morale. 25X1

Egypt: Oil and the Balance of Payments

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We expect oil revenues to decline substantially by the end of the decade, requiring Egypt to find alternative revenue sources to fund its large current account deficits or institute austerity measures that would risk domestic instability. Over the next two years, crude oil production will increase by over 200,000 barrels per day—approaching 1 million barrels per day in 1986. These increases in production, however, will be largely used to satisfy rapidly rising domestic consumption, which is stimulated by heavily subsidized domestic energy prices. Even with some expected moderation in the rate of increase in domestic consumption and greater domestic use of natural gas, the amount of oil available for export will shrink considerably by 1990 unless there are large new finds. Lower oil export earnings could cause the Egyptian Government to rethink its relationship with key aid donors, especially the United States, if it perceives that those donors are not meeting its financial needs. Cairo could pursue more vigorously full reintegration into the Arab fold. Such a move could have negative implications for US-Egyptian bilateral relations because the other Arab states might insist that Egypt distance itself somewhat from the United States as a prerequisite for aid.

The Importance of Oil

The oil industry remains a leading sector of the Egyptian economy despite the downturn in the world oil market and the resulting reduction in revenues. Petroleum accounted for almost two-thirds of Egypt's commodity exports and over 20 percent of total foreign exchange earnings in 1983. Moreover, earnings transferred from the government-owned Egyptian General Petroleum Corporation (EGPC) and income taxes on petroleum companies generated 16 percent of government revenues in fiscal year (FY) 1982/83.[2] These revenues, plus Suez Canal tolls and remittances from expatriate workers, have enabled the government to fund expensive but politically necessary subsidies and development projects. 25X1

Recent Performance of the Oil Sector

Egyptian oil production has risen over 20 percent since 1981. It averaged about 720,000 barrels per day (b/d) last year, a record. The increase was largely the result of sophisticated secondary recovery techniques in the larger offshore oilfields and the bringing into production of several new discoveries. Even though domestic consumption has increased 10 to 13 percent in each of the last few years, the volume of Egypt's exports has risen slightly—about 23,000 b/d in the two-year period—to about 210,000 b/d last year. (Oil exported by Egypt's production-sharing partners in repayment for exploration, development, and operating costs is not included in Egyptian oil export and earnings data.) 25X1

We believe revenues fell to $2.2 billion last year after peaking at an estimated $2.8 billion in 1981.[3] This occurred despite increases in production and government attempts to capitalize on oil market changes with frequent price adjustments. Prices for Egyptian oil declined from an average of close to 25X1

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[2] The fiscal year is 1 July to 30 June.
[3] The exact amount of Egyptian oil revenues is difficult to determine.

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Egypt: Current Account [a] *Billion US $*

	1982	1983 [b]	1984 [c]
Trade balance	−5.0	−5.5	−5.8
Exports, f.o.b.	3.6	3.5	3.6
Oil	2.3	2.2	2.3
Imports, c.i.f.	8.6	9.0	9.4
Net services	2.6	3.2	3.2
Receipts	5.4	6.3	6.5
Remittances	2.1	2.8	3.0
Suez Canal	0.9	1.0	1.0
Tourism	0.6	0.7	0.7
Other	1.8	1.8	1.8
Payments	2.9	3.1	3.3
Unrequited transfers	NEGL	0.1	0.1
Current account balance	**−2.4**	**−2.2**	**−2.5**

[redacted]
[b] Preliminary.
[c] Estimated.

[redacted]

$32 per barrel in 1982 to about $28 in 1983. The drop in oil earnings, however, was offset by increases in officially reported worker remittances, and we estimate Egypt's current account deficit declined from $2.4 billion in 1982 to $2.2 billion in 1983. [redacted]

The rapid rise in domestic consumption continued to be a major factor in the export picture. The increases—averaging 13 percent annually in 1982 and 1983—have resulted from rapid economic growth, a shift toward more energy-intensive investment, and government policies that, [redacted] hold domestic energy prices to about one-sixth of international levels. Moreover, Egypt has not been able to fully benefit from potential natural gas production because of inadequate gas production and distribution facilities. Gas reserves—estimates vary from 720 million to 1.8 billion barrels of oil equivalent (boe)—are not sufficient to support the development of export facilities. [redacted]

Egypt: Near-Term Production Targets *Thousand b/d*

	Average Production, 1983	Incremental Production 1984	1985	1986
GUPCO	530	50 to 75	NEGL	75
Petrobel/IEOC	140	NEGL	NEGL	20 to 60
SUCO	30	20	70 to 130	NEGL
Other	20	NEGL	NEGL	NEGL
Total production	**720**	**790 to 815**	**860 to 945**	**955 to 1,080**

[redacted]

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The Outlook for 1984 and Beyond

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We estimate, [redacted] that actual production this year probably will average between 790,000 and 815,000 b/d. As a result, Cairo's oil earnings will increase only marginally—to about $2.3 billion—unless fighting in the Persian Gulf sparks a sharp runup in oil prices. Domestic consumption will continue to rise at a pace probably approximating last year's 13 percent. Any economic policy reforms designed to limit consumption probably will not be enacted before the end of the year. Cairo avoided major increases in consumer prices before the parliamentary elections in May and probably will take no action until after the formal convening of the new People's Assembly in October or November. [redacted]

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Production Forecast

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We believe that Egypt's current proved crude oil reserves are at least 3 billion barrels. Output will probably increase steadily in 1985 and 1986. This judgment is based on current reserve estimates and

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Egypt: Major Companies' Production Forecasts

GUPCO. Company officials forecast that their production will increase to over 600,000 b/d during 1984, largely as a result of production increases at existing fields and some smaller new fields being brought onstream, according to Embassy sources. According to press interviews with company officials, by 1986 GUPCO output should be close to 700,000 b/d as a result of production from two new blocks in the Gulf of Suez. GUPCO has closed some smaller fields that it plans to bring on line in 1986. These fields are to be used largely to offset expected production declines from older fields.

Petrobel/IEOC. The Petrobel consortium currently produces about 140,000 b/d, largely from its Bala'im offshore fields. Petrobel hopes to complete construction of a water-injection plant in 1985. The company expects total production in 1986 to reach 160,000 to 200,000 b/d, according to Embassy reporting.

SUCO. According to company discussions with Embassy officers, SUCO plans to raise production from its Ras Budran field to 60,000 to 70,000 b/d by the end of this year after gas-lift and water-injection facilities are installed. SUCO representatives report that the Zeit Bay concession, which would be SUCO's largest producing area, is also on schedule and must begin producing by March 1985 to satisfy the company's contract with EGPC. Production facilities there are being designed to accommodate 100,000 b/d, but it is too early to predict how the reservoir will behave and whether the production goal will be met.

on the need for operating companies to meet exploration and production deadlines specified in their contracts with EGPC. The increases will be largely accomplished by three operating companies—GUPCO (Amoco), Petrobel/IEOC (ENI), and SUCO (Deminex, BP, Shell). These three have made more than two-thirds of the new discoveries since 1981.

Outlook for Domestic Consumption 25X1

We believe that Egyptian demand for energy will remain at an artificially high level because of energy subsidies. Demand will drop significantly in the longer run only with serious reforms in energy management. Cairo is under pressure from the IMF and World Bank to reduce explicit and hidden oil subsidies—estimated by the Bank to be about $3-4 billion in 1983—and to raise domestic fuel prices to world market levels. Although the Bank had earlier insisted that prices reach world levels in five years, both the Bank and the Fund now seem willing to accept a 10-year adjustment program because of the extent of the pricing gap. Cairo appears to accept the idea of price adjustments, and its need for continued outside assistance probably will cause it to enact some reforms beginning in 1985. We believe, however, that political considerations will deter the government from adopting reforms as extensive as the Fund and Bank are advocating.

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Planned increases in the production and usage of Egypt's natural gas reserves will strongly influence the pace of domestic oil consumption. The Egyptian Government, with some funding from the World Bank, is encouraging growth in household and industrial use of gas. According to press reports, the government plans to increase gas production and use from the current 80,000 b/doe to 114,000

b/doe by 1985. Further increases to 194,000 b/doe are planned by 1990. These increases, if realized, would restrain somewhat the fast pace of domestic oil use.

Development of nuclear power as a substitute for thermal power generation is more problematic. Cairo's plan to finance part of its nuclear power program by setting aside excess oil revenues has been stymied by the slump in oil prices. Although some money might have been set aside in 1980 and 1981 before oil revenues started to fall, we believe it unlikely that further contributions have been made or that the size of the "Alternative Energy Fund" will support planned nuclear development.

The Egyptian nuclear power plan calls for an expenditure of $2 billion for the first two of eight planned facilities. The plan depends heavily on outside trade and development credits. Although the first two reactors are supposed to be operational by late 1989 or 1990, this is unlikely because financing has not been secured. The home governments of interested companies in France, West Germany, and Italy are withholding credits because they doubt Egypt's ability to repay. The US Export-Import Bank turned down a financing proposal by two US companies last August.

We believe the Egyptian Government will find it hard to reduce domestic oil consumption in the near term even with increases in domestic prices and use of natural gas. At best, we foresee a decline in the annual growth of consumption to about 8 percent in 1985 and possibly 5 percent in 1988.

Export and Revenue Scenarios

We believe that Egyptian oil production will peak at about 950,000 b/d in 1986, provided company projections and our assumptions about pricing are close to the mark. Egypt would earn peak annual revenues of about $3 billion at that level of production. This level is not sustainable, however, without substantial new finds or sharply increased prices. According to Embassy reporting, foreign oil company interest in exploration has leveled off in the

Oil Price Assumptions

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The current outlook for international oil prices bodes ill for Egyptian oil earnings. Our energy projections assume declining real oil prices to 1985 and flat or moderately increasing real oil prices to 1990. These assumptions could be overturned by a major supply disruption resulting from escalation of hostilities in the Gulf. Conversely, a cease-fire between Iran and Iraq or a surge in production by another major supplier, such as Nigeria, would further dampen the outlook for prices.

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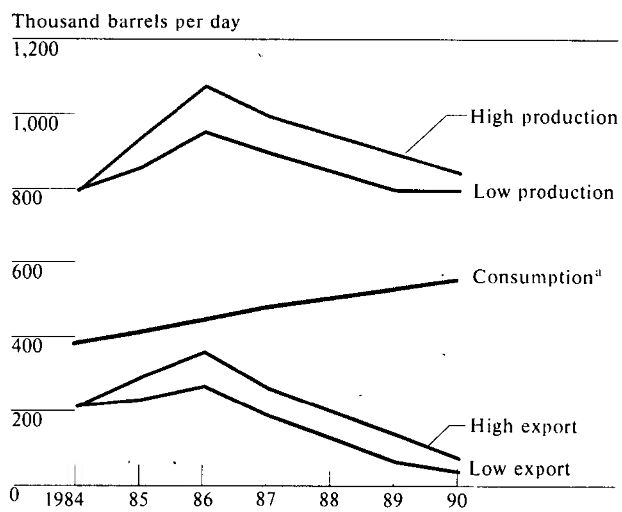
Egypt: Alternate Oil-Sector Scenarios, High and Low Projections, 1984-90



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[a] Assumes growth in domestic oil consumption slows to 8 percent per year in 1985 because of government disincentives and increased gas usage; and further to 5 percent per year in 1988. Failure to achieve these consumption cuts will result in lower export levels.

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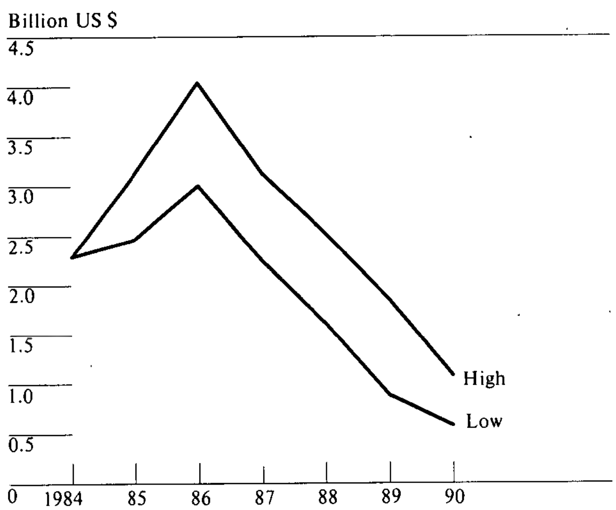
Egypt: Oil Revenues, 1984-90 Projections



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past two years. New finds are unlikely to be made and exploited, therefore, before the end of the decade. Our judgment is that export revenues will fall well below $1 billion by the end of the decade, given probable production slowdowns and our assumptions about domestic consumption growth.

Under the more optimistic production scenario of nearly 1.1 million b/d for 1986, revenues would peak that year but would still fall substantially by 1990. Assuming that the Egyptian Government did not let higher production hinder oil conservation efforts, revenues would peak at just over $4 billion in 1986 and probably fall thereafter. Earnings in 1990 would probably be a little over $1 billion. The fall in revenues to about half of current levels would deal a major blow to Egypt's foreign payments position and the government budget, even under this optimistic scenario. Unless new sources of earnings—such as more worker remittances or nonoil exports—were found or imports were drastically cut, current account deficits in excess of $4 billion annually could occur at the end of the decade. 25X1

Implications

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There are few alternatives to aid if, as we expect, oil revenues decline substantially. Higher Suez Canal earnings or worker remittances are unlikely to replace falling oil revenues. Canal earnings will be constrained by capacity even if oil trade picks up because plans to expand the Canal to accommodate larger ships have been put on hold. Officially recorded worker remittances may rise somewhat if exchange rates are aligned to capture funds that are now remitted through the parallel exchange market and are not available to the Central Bank. This would be a one-time increase, however, and economic conditions in the Gulf states do not augur well for rising remittances. 25X1

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For the United States. A widening financial gap would cause Cairo to press its aid donors—especially the United States—even harder to increase aid or provide debt relief. There is already widespread criticism within Egypt that debt repayments to the United States are putting undue strain on Egyptian finances and that project aid is serving only the USAID bureaucracy and private contractors. This perception would be reinforced if, as expected, petroleum revenues decline at the same time that repayments on military debts to the United States are rising. Should Washington refuse to give more aid or grant debt relief, Cairo would probably conclude that it had no choice but to explore additional aid options. 25X1

A whole range of US strategic interests could be negatively affected if Cairo seeks aid from other donors, particularly Saudi Arabia and other Persian Gulf states. The quest for Arab aid could cause Cairo to consider distancing itself from the United States. A press for full reintegration into the Arab fold could also undermine Egyptian support for future US Middle East peace initiatives and could have negative implications for Egyptian-Israeli relations, although these have already cooled as Egypt has developed its unofficial ties with the moderate Arab states. 25X1

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Population and Labor Force Consequences of the Iran-Iraq War

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We believe the Iran-Iraq war will not place demographic constraints on postwar recovery as did the heavy manpower losses in World War I Europe. Military mobilization, the departure of foreign workers and war casualties are only slightly postponing the day when both the Iranian and Iraqi regimes must cope with high levels of youth unemployment. The number of young men in their teens and early twenties, however, will continue to increase rapidly in both countries, given their earlier high annual rates—2.8 to 3.2 percent—of population growth.

Growing Military Forces

Military conscripts and volunteers have temporarily removed large numbers of men, mostly youth, from the labor force. In Iran we estimate that roughly 7 percent of the 9.8 million eligible males 15 to 49 are in military and paramilitary organizations. In Iraq the share is roughly 20 percent of the 3.3 million eligible males.

Immigration/Emigration

The war has had an uneven effect on immigration and emigration for Iran and Iraq that in turn influences labor force size. In Iran, war-related international population movements have been inconsequential. Roughly 15,000 Shias of Iranian descent who were expelled by Iraq have been isolated by Iranian authorities who view them as potential Iraqi sympathizers. According to Iranian press reports, the number of expatriates in Iran (a few thousand) has remained unchanged during the course of the war.

In Iraq, about one-third of the 1.5 million foreign workers present in 1982 (including about 1.3 million Egyptians, according to US Interest Section reports) have departed. Burgeoning oil revenues before the war encouraged Iraq to undertake ambitious economic development projects that required the help of foreign workers. These projects were continued during the early days of the war. As a result of economic constraints and fighting around Al Basrah, however, as many as one-half of the 250,000 Asian expatriate workers and 30 percent of the Egyptians were gone by early 1984, according to the US Interest Section. According to US officials, the exodus and Iraq's military manpower needs have resulted in domestic labor force shortfalls that have been partly filled by Iraqi women. An expanded war and depressed economy would further accelerate the foreign workers' departure.

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Permanent Labor Force Losses

War-Related Deaths. Western correspondents covering the Iran-Iraq war have incorrectly drawn parallels with the extent of battlefield losses in World War I. According to our calculations, both Iranian and Iraqi military casualties, as a percentage of total national population, fall far short of the losses suffered by combatants in World War I. Confirmed military deaths to date in the Iran-Iraq war represent a loss of approximately 200,000 or 0.5 percent of Iran's and 70,000 or 0.6 percent of Iraq's population at the outset of the war. Even our high-range estimates for military deaths show only a 1.6-percent loss for Iran and a 1.7-percent loss for Iraq. Among the frontline countries in World War I, France lost 3.3 percent of its prewar population to military deaths; Germany lost 3.0 percent; and Austria-Hungary, 2.1 percent.

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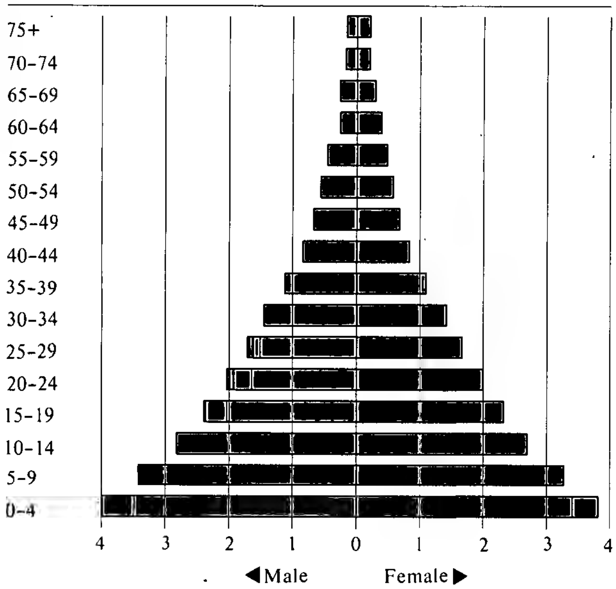
Civilian deaths and displacements caused by the Iran-Iraq war have also been light compared with Europe's experience in World War I. We estimate

Iran: Population Pyramid Illustrating Estimated Demographic Impact of the Iran-Iraq War in 1985

Population in Millions

Legend

- Estimated Iranian population by age and sex in 1985
- Confirmed military losses
- High estimate for military losses and 10 percent of births postponed.



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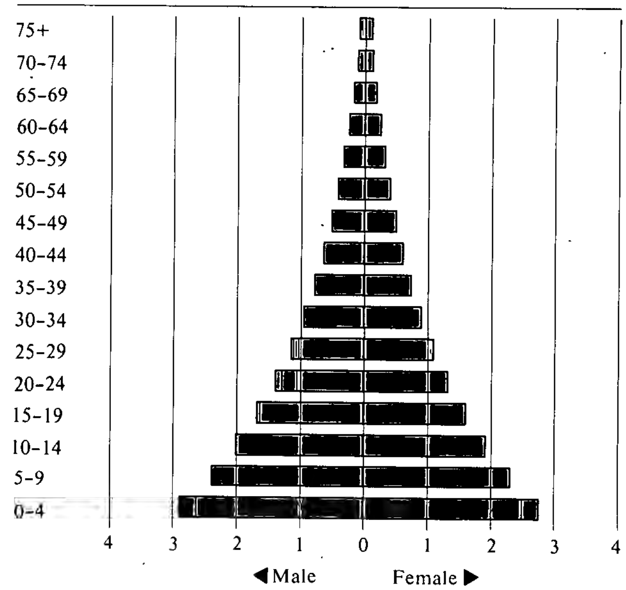
Iraq: Population Pyramid Illustrating Estimated Demographic Impact of the Iran-Iraq War in 1985

Population in Millions

Legend

- Estimated Iraqi population by age and sex in 1985
- Confirmed military losses
- High-estimate for military losses and 10 percent of births postponed



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civilian deaths from the Iran-Iraq war at about 60,000—mostly Iranians. The recent UN-sponsored agreement to curtail attacks on civilian targets suggests that both Iran and Iraq may continue to limit civilian losses. The initial Iraqi invasion created at least 1.5 million Iranian refugees, and most refugees still are unable to return home or resume productive employment. Iraqi civilians have suffered few population displacements. Only a few thousand Iraqi civilians have moved from small villages in the sparsely settled area south of Al Basrah.

In Europe (excluding the Soviet Union) there were 5 million civilian deaths during World War I attributed directly to the war. For example, civilian deaths in Belgium exceeded by two-and-a-half times the number of military casualties. Combined civilian losses and military deaths totaled 5.4 percent of Belgium's pre-World-War-I population.

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Nonetheless, military casualties in the Iran-Iraq war are concentrated among males in their teens and early twenties, which will leave a permanent mark on the age and sex structure of each country's population. In Iran, approximately 5 percent of the 3.8 million males between 15 and 24 have died

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during the four years of fighting, according to our estimates based on a variety of sources. In Iraq, deaths to young men represent roughly 6 percent of the 1.3 million in the same age group. In contrast, France and Germany during World War I lost approximately 20 percent of their 20- to 24-year-old males. [redacted]

Births Postponed. We believe that war mobilization to date has not disrupted expected birth rates to any significant extent in either Iran or Iraq. Away from the battlefront, we expect that traditional patterns of early marriage and childbearing have continued undisturbed by the war. Military personnel on both sides are granted frequent leave. Iranian young women are exhorted to marry wounded veterans, and war widows on both sides are encouraged to remarry promptly, according to press reports. [redacted]

High levels of fertility in both countries (an average of six live births per woman of reproductive age, according to UN estimates) ensure that the populations of both countries will continue to grow rapidly in spite of the war deaths. Despite the war, Iran's population is growing at an estimated 3.0 percent annually and will increase by 6.0 million people between 1980 and 1985. Iraq's population is growing at an estimated 3.2 percent annually and will increase by 2.3 million during the same period. [redacted]

In contrast to the continuation of rapid population growth in Iran and Iraq, Europe's population in 1920 was only about what it had been at the outset of World War I in 1914—319 million—because births during the war only offset mortality losses. A decline in European birth rates that had begun before the war accelerated sharply during the war. Military mobilization caused marriages and births to be postponed. The postponed births by war's end totaled an estimated 10.8 million—a population loss considerably larger than the 6.6 million military dead. This drop in fertility between 1914 and 1919 resulted in newborn age groups one-third to one-half the size they would have been had there been no war. [redacted]

The Effect of Higher Losses and Lower Birth Rates

Postwar statistics may show that birth rates did decline and that war deaths were higher than those confirmed to date. If we take our high-range estimates [redacted] for battlefield 25X1
and civilian deaths and assume that military mobilization and disruptions to civilian life have caused a 10-percent drop in the number of births since the war began, total population losses for Iran and Iraq run between 3.6 and 3.7 percent of their prewar population during the 1980-85 period. Iran's war-related population loss, for example, would be 1,381,000. Slightly less than half of the total (660,000) would be deaths to young males, thus permanent losses to the labor force. Iran would also have 721,000 fewer children under five in 1985. A similar 10-percent drop in the number of births for Iraq would represent a war-related population loss by 1985 of 262,000 children under five. This loss, combined with high-range estimates for deaths (225,000), would yield a total Iraqi war-related population loss of about 487,000 (3.7 percent of the prewar population) for the 1980-85 period. [redacted]

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The Demographic Outlook

We calculate that both countries will be able to sustain their current casualty rates and maintain current military recruiting patterns without encountering any population resource limits. Rapid rates of population growth over the past 15 to 20 years guarantee that both countries will have growing teenage male populations throughout the 1980s—despite deaths on the battlefield. In Iran, the number of 15- to 17-year-old males will increase by about 550,000 per year in the second half of the 1980s; in Iraq, the number will increase by about 180,000 per year. [redacted] 25X1

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We do not believe that the war will place demographic constraints on postwar recovery as did the heavy manpower losses of World War I. If the war settles into a war of attrition for the rest of the decade, the populations of both Iran and Iraq will

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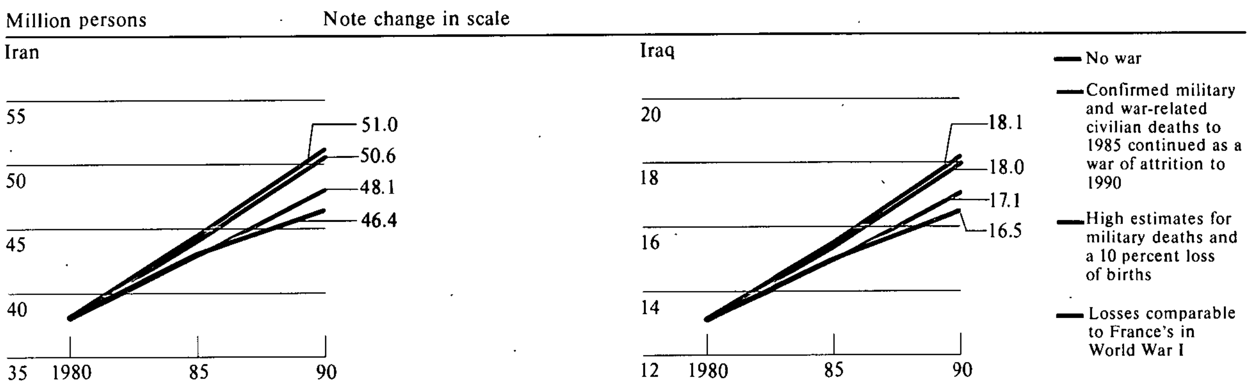
Alternative Population Growth Consequences of the Iran-Iraq War



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grow only slightly less rapidly than if there were no war. Iran's population in 1990, for example, would be roughly 50.6 million, or only 400,000 less than expected. Labor surpluses rather than shortages are likely to confront the Iranian regime in the late 1980s. For Iraq, the war-of-attrition scenario will result in a 1990 population of about 18.0 million, or 150,000 less than expected under a no-war scenario.

An Alternative Scenario: World War I Revisited

Even if, over the next several years, fighting between Iran and Iraq escalates dramatically to the levels of World War I, we calculate that continuing Iranian and Iraqi high rates of natural increase will enable them to cope with population losses. In Iran and Iraq losses on the scale of World War I would require:

- Additional military deaths six times those now confirmed dead, or twice the current highest estimates for military losses.
- Additional civilian war-related deaths eight times higher than experienced to date.
- Postponed births representing population losses of 20 percent of the expected under-five 1990 population.

Even under this high casualty and fertility loss scenario, Iran's population will still grow at the rate of 1.5 percent annually and Iraq's at 1.9 percent annually—both near the world's overall 1.8-percent annual growth rate. For both countries, the casualties would be concentrated among young males, thereby resulting in potential labor force shortages in this age group. A lower number of births would reduce the number of children under five years of age in 1990, again guaranteeing probable shortfalls when this group moves into the labor force: 25X1

- For Iran, military deaths would total 1.2 million for the five-year period, and war-related civilian deaths and declines in fertility would cause a population loss of about 3.3 million.
- For Iraq, military deaths would total approximately 450,000, and civilian deaths and fertility declines would create a total population loss of approximately 1.2 million. 25X1

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World Rice Market: Buffeting the LDCs [redacted]

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Global rice reserves that were accumulated to record levels in the late 1970s have fallen to the lowest level in eight years. At the same time, LDC rice importers, lacking foreign exchange, have been forced to curtail purchases of foreign rice, keeping world prices low. Some LDC governments are facing urban populations angry at interruptions in the rice supply and at rapidly rising local prices. We believe localized rice shortages and high domestic prices have the potential to touch off civil disorders. For exporters, reduced demand has stiffened competition and depressed earnings. [redacted]

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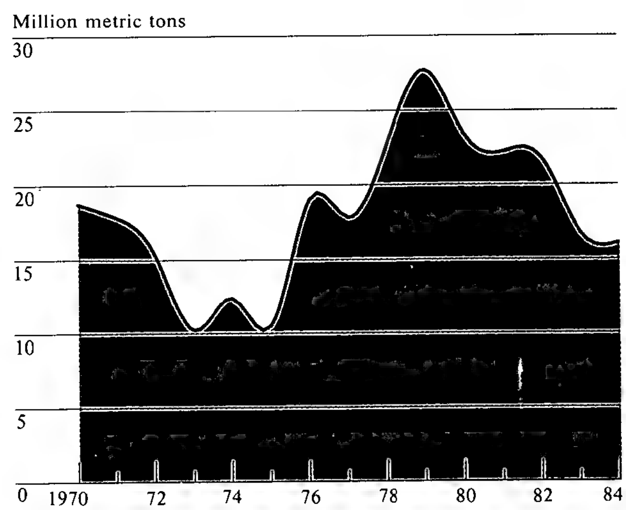
World Rice Stocks, 1970-84[a]



[a] Ending stocks on a milled basis: stock data are based on an aggregate of different market years and should not be construed as representing world stock levels at a fixed point in time. Stock data are not available for all countries and exclude the USSR, China, North Korea, and all parts of Eastern Europe.

[redacted]

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Evolving Market Trends

The advent of the "Green Revolution" in the mid-1960s permitted sharply increased rice output and rapidly rising consumption levels. According to USDA estimates, production outpaced consumption until the late 1970s. As a consequence, global stocks grew to three times the level of the early 1960s and provided a safety net in case of major crop failures. These trends were halted in the late 1970s when production gains tapered off and consumer demand continued to grow, spurred by rapid population growth and rising incomes. To meet demand, global stocks have been drawn down to levels we consider precarious. [redacted]

The outlook for the present year is for another record crop, but further stock reductions. Production is forecast to reach 302.8 million metric tons (milled basis) in the marketing year ending 31 July 1984, while consumption will be slightly higher at 303.2 million tons. According to USDA forecasts, rice stocks in non-Communist countries will dip to about 16.3 million tons, 41 percent below the peak in 1978-79. The stocks-to-consumption ratio will fall to 5.4 percent, the lowest level since 1973. Moreover, preliminary projections for the next marketing year suggest a further drop in stocks of nearly a million tons. [redacted]

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[redacted]

LDC Importer Problems

Developing country importers are encountering serious problems because of foreign exchange shortages and their pursuit of economic adjustment

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programs. Many of these countries—Brazil, Liberia, and Senegal, for example—have been unable to maintain per capita consumption levels. Faced with rice shortages and budget strains, many countries chose to raise politically sensitive rice prices:

- The political impact of a doubling of rice prices over the past two months in **Sierra Leone** is arousing concern in the government. According to Embassy reporting, intense public discussion and grumbling have focused on the retail price of rice.

- In **Burundi**, the price of rice, an important food for the salaried population, has risen by 50 to 60 percent in recent months, according to Embassy reporting. So far the most visible result of rising staple costs has been rising crime, but the Embassy believes a continuation of the trend could cause growing political unrest.

- In **Somalia**, where shortages of foreign exchange have constricted commercial imports, the price of rice rose 120 percent between December and March, according to Embassy reporting.

- In **Ghana**, the price of rice increased 250 percent in December. Embassy reporting indicates that widespread opposition to price increases in basic commodities, such as rice, has begun to surface, particularly among workers and other supporters of the Rawlings regime.

In the past, developing country importers were able to turn to foreign supplies to cover shortfalls in domestic rice production. Most no longer have this option. During the 1970s, rice imports by developing countries rose an average of 4 percent annually, according to USDA, and peaked in 1981 at more than 9 million tons. LDC rice imports plummeted in 1982 to 6.4 million tons as many countries cut back all imports sharply. Rice imports recovered slightly in 1983 but are expected to drop again in 1984 by about 3 percent, according to USDA estimates, despite rice export prices that are sharply lower.

Exporter Problems

Lower demand is having feedback effects on the world's major rice exporters as sales decline, prices weaken, and earnings drop. According to USDA projections, total rice exports will be the lowest in six years. To drum up sales, some rice exporters have moved to below-market credit terms and other inducements such as barter and countertrade arrangements to encourage foreign sales. Some are selling domestic rice reserves in an effort to generate foreign exchange:

- Thailand, the world's largest rice exporter and historically a cash seller, is now extending credit on liberal terms and cutting prices. In June, Bangladesh bought 325,000 tons at $30 per ton below the posted price, at least part of which was on one- to two-year credit at 11.5-percent interest.

- According to Embassy reporting and USDA estimates, domestic rice reserves in both Thailand and Burma have been sold abroad in the last year. 25X1

Despite the drive to push exports, revenues from foreign rice sales have sagged. Prices remain weak because of low effective demand. According to USDA statistics, Thai rice earnings were down slightly in 1983 from the already depressed level of 1982, even though export volume last year was 20 25X1 percent above 1981 levels. The 1983 rice earnings of Burma and Pakistan, although up from 1982, failed to recover to 1981 levels despite a large increase in sales volume. Preliminary Embassy reporting indicates that both Pakistan and Burma face further declines in earnings. 25X1

Outlook and Implications

The world rice situation is likely to remain a source of concern in the Third World. In the near term, the production situation depends crucially on

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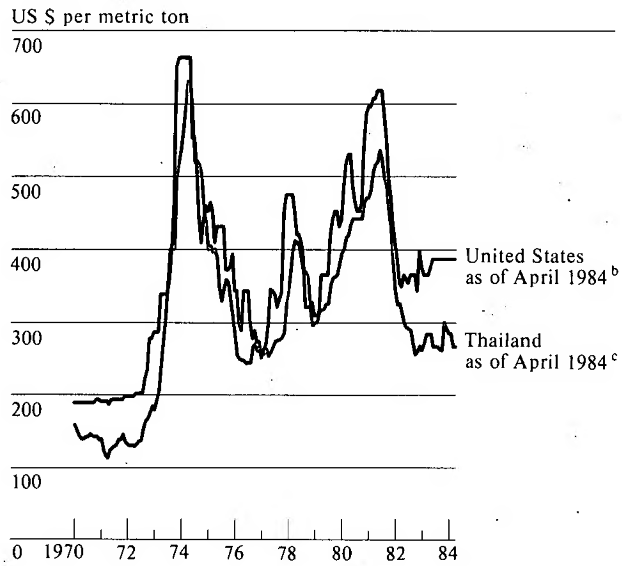
World Rice Prices, 1970-84[a]



[a] Based on monthly averages.

[b] Milled, Zenith No. 2 medium-grain miller-to-distributor, f.o.b. New Orleans.

[c] White milled 5% broken, f.o.b. Bangkok.

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weather patterns. Approximately 90 percent of the world's rice crop is produced in Asia; only about half of the Asian acreage is irrigated. Thus, the balance between world rice supplies and demand hinges on the amount and timeliness of rain brought by the southwest monsoon that is now advancing across Asia. Although early reports indicate that the monsoon began on time in late May across much of southern Asia, bringing heavy rain to southern India and Burma, and is now progressing northward in a timely fashion, consistent rains in the coming months will be critical. A significant crop shortfall in one or two important producing countries—such as China, India, Indonesia, or Thailand—could send shock waves through the marketplace. Should this occur, world stocks could be insufficient to offset the shortage. Alternatively, even with record world production, little stock rebuilding would occur because of consumption increases. 25X1

In the longer run, demographic factors point to a steady increase in rice demand, not only throughout Africa but in the rapidly growing urban population centers of Asia and Latin America. World rice producers, however, have already absorbed most of the production benefits brought by the Green Revolution. Additional productivity gains may be difficult to achieve and could prove very expensive. At the same time, present government policies, if continued, will lead to increased instability in the rice market:

- Government policies common to most African states have discouraged domestic production of staple foods by keeping prices low to subsidize urban consumers.

- Government policies aimed at achieving rice self-sufficiency by major rice consumers such as India, Indonesia, and South Korea have added further volatility to the market. These countries are self-sufficient only in years when rainfall is adequate to take full advantage of the benefits of high-yield seeds and large applications of fertilizer; in off years, they are large and unpredictable buyers. 25X1 25X1

Localized rice shortages in the Third World and high domestic prices have the potential to touch off violent civil disorders. Public demonstrations against disruptions in rice supplies in Nigeria and Bolivia and food riots in Tunisia and the Dominican Republic earlier this year underscore the dangers of raising food prices. We believe the likelihood of rice-related disorders is greatest in Sub-Saharan Africa. In this region a convergence of forces—extended drought, rice and other grain shortages, austerity programs, tribal factionalism, and leftist influences—has increased the potential for disruptions. 25X1

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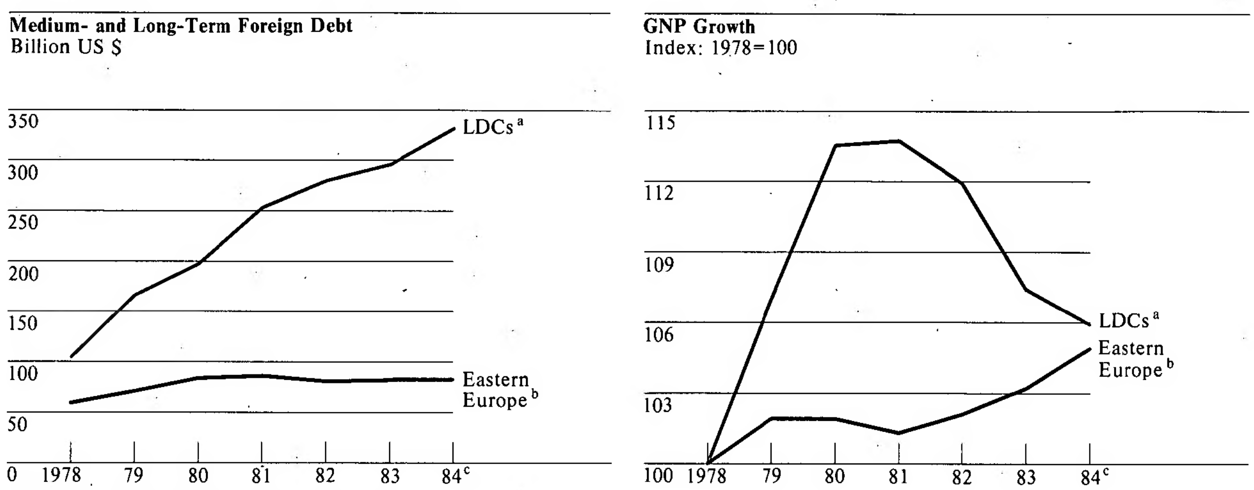
Selected Debt-Troubled Countries: Foreign Debt and Economic Growth



[a] Argentina, Brazil, Chile, Mexico, and Venezuela.
[b] Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, and Yugoslavia.
[c] Projected.

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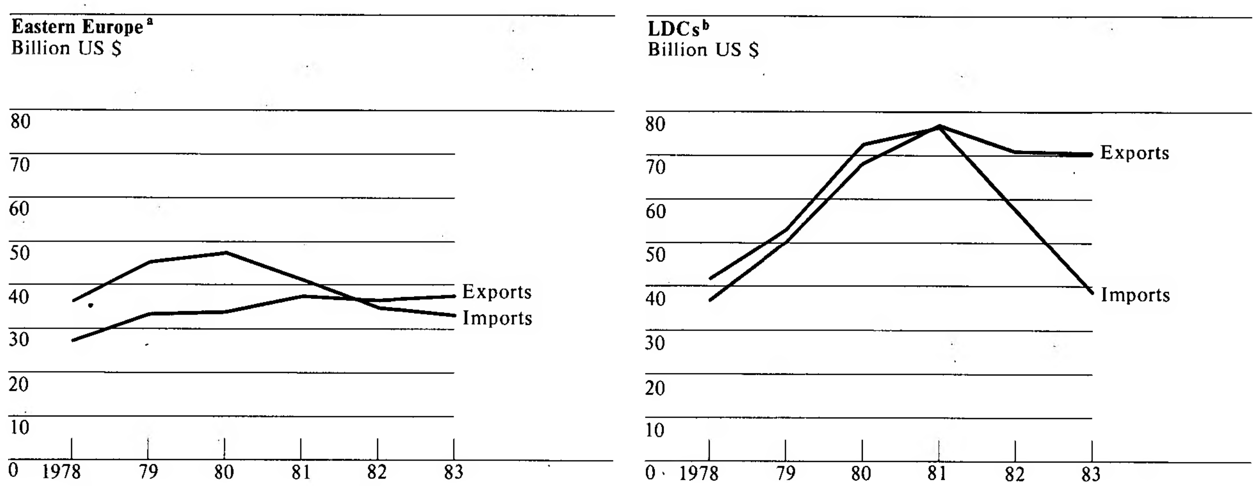
Selected Debt-Troubled Countries: Trade Adjustment



[a] Bulgaria, Czechoslovakia, East Germany, Hungary, Poland, Romania, and Yugoslavia.
[b] Argentina, Brazil, Chile, Mexico, and Venezuela.

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